

Internal Revenue Service
memorandum

TLN-7783-88
WHEARD CC:TL:TS

date: OCT 14 1988

to: District Counsel, Brooklyn

NA:BRK

from: Assistant Chief Counsel (Tax Litigation) CC:TL

subject: [REDACTED]

This is in response to your request for technical advice dated July 14, 1988.

ISSUE

Whether the execution of a Form 906 closing agreement for a partner's [REDACTED] pre-TEFRA year, which references future years for ITC, discharge of indebtedness and computation of basis, converts part or all of the partner's partnership items for TEFRA years to non-TEFRA items.

CONCLUSION

Under I.R.C. § 6231(b)(1)(C) only a comprehensive settlement agreement with respect to a partner's partnership items will convert those items to nonpartnership items. If the agreement is not comprehensive, none of the partnership items will convert.

Thus, the form 906 closing agreement in the instant case executed with respect to a non-TEFRA year and which also determines the treatment of only a few partnership items for future TEFRA years does not convert any of the partner's partnership items to nonpartnership items for the future years in issue.

FACTS

A partner and the Service executed a Form 906 with respect to the partner's [REDACTED] tax year, but which also referenced future years. The terms of the agreement are set forth in full as follows:

WHEREAS, petitioner is a partner in the partnership known as [REDACTED]

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WHEREAS, petitioner has made a total cash investment in the partnership known as [REDACTED] of \$ [REDACTED] in [REDACTED].

WHEREAS, petitioner has claimed deductions in the amount of \$ [REDACTED] for his distributive share of the loss claimed by [REDACTED] partnership for the taxable year ended [REDACTED].

WHEREAS, petitioner claimed losses, deductions and credits with respect to his partnership interest beginning with the taxable year [REDACTED].

NOW, IT IS HEREBY DETERMINED AND AGREED for Federal income tax purposes:

- (1) That petitioner is entitled to an ordinary deduction in the amount of \$ [REDACTED] for [REDACTED], said deduction being equal to the petitioner's cash investment in the partnership, but limited to the loss claimed per the tax return of [REDACTED].
- (2) That petitioner is not entitled to any increase in the basis of his partnership interest as a result of any nonrecourse obligation until such time and only to the extent that the nonrecourse obligation is paid by making cash payments on the nonrecourse obligation.
- (3) That petitioner is not entitled to investment credit with respect to his interest in [REDACTED] for any taxable year.
- (4) That petitioner has a basis of \$ [REDACTED] as of [REDACTED] [REDACTED] for his interest in [REDACTED], plus if deemed to be a general partner in [REDACTED] [REDACTED] the petitioners share of all income and all liabilities to date of that partnership.
- (5) That the discharge or forgiveness of the nonrecourse obligation in any year subsequent to the taxable year ended [REDACTED] will not result in gross income to the petitioner in any taxable year.

The Appeals Officer who negotiated the terms of the agreement claims the agreement was designed to effect [REDACTED] and all subsequent years. Petitioner's representative claims the agreement was only meant to effect the [REDACTED] year.

DISCUSSION

I.R.C. § 6231(b)(1)(C) provides:

(b) Items Cease To Be Partnership Items in Certain Cases

(1) **In general.**— For purposes of this subchapter, the partnership items of a partner for a partnership taxable year shall become nonpartnership items as of the date—
. . .

(C) the Secretary enters into a settlement agreement with the partner with respect to such items . . .

I. ALL PARTNERSHIP ITEMS CONVERT OR NONE DO

Conversion under the 4 provisions of section 6231(b) was not intended to be piecemeal. For instance, under subparagraph (b)(1)(B) all of a partner's partnership items are converted to nonpartnership items when a partner files suit under section 6228(b) after the Service fails to allow an administrative adjustment request with respect to any of such items. I.R.C. § 6228(b)(1).

Similarly, under subparagraph (b)(1)(A) the Service may inform a partner that all of his partnership items are converted to nonpartnership items in two circumstances. See I.R.C. §§ 6231(b)(2); 6227(c)(3) (notice converting all of a notice partner's partnership items permitted when request for administrative adjustment of partnership items is made by that notice partner); Temp. Treas. Reg. § 301.6222(b)-2T(a)(2) (when partner files notice of inconsistent treatment the Service may treat all of his partnership items as nonpartnership items).

Under subparagraph (b)(1)(D) and section 6223(e) all of a partner's partnership items for a taxable year convert to nonpartnership item either by election or operation of law when certain notice requirements are not met. Furthermore all of a partner's items convert under the special enforcement regulations provided for in section 6231(c).

As a matter of policy, it is apparent that Congress chose to avoid a piecemeal conversion of partnership items to non-partnership items. This policy is especially applicable under section 6231(b)(1)(C). If conversion were allowed to be piecemeal, four assessment procedures would potentially apply: the regular deficiency procedures, a TEFRA proceeding, a converted partnership item deficiency procedure, and an affected item deficiency procedure. Three periods for assessment would apply: sections 6501, 6229(a) and 6229(f). Tracking and administering all the procedures and assessment dates would be unnecessarily complex and difficult.

In short, Congress intended that all of a partner's partnership items convert if any convert.

II. A SETTLEMENT AGREEMENT MUST BE COMPREHENSIVE IN ORDER TO CONVERT PARTNERSHIP ITEMS TO NONPARTNERSHIP ITEMS

The statutory language of section 6231(b)(1)(C) converts "the partnership items of a partner" to nonpartnership items when an agreement is reached with respect to "such items" (emphasis supplied). The use of the plural term "items" indicates that only a comprehensive agreement with respect to partnership items will convert the partnership items of a partner to nonpartnership items. If the statutory intent was to convert all items when an agreement was reached with respect to only a single item, then the statute would have required conversion when a settlement agreement was executed with respect to "any item". Thus, a settlement with respect to one item, such as depreciation with respect to a low value piece of equipment (e.g., a pencil) will not operate to convert the partnership items of a partner to nonpartnership items.

If an agreement with respect to only a few items converted all of a partner's partnership items to nonpartnership items the unaddressed items would remain unresolved and subject to litigation. If numerous partners agreed to settle only a few items or the consistent settlement rule applied to settle these items, many statutory notices would be issued and there would be multiple litigation (with possible inconsistent results) with respect to the identical remaining issues.

Only the utilization of a comprehensive agreement as the converting event is consistent with Congressional intent to provide either a unified TEFRA proceeding or a unified settlement. Cf. sections 6221 and 6224(c). Temp. Treas. Reg. § 301.6224(c)-3T(b) reflects the policy of uniform litigation or

settlement in requiring that a settlement agreement must be comprehensive for the consistent settlement rule to apply: "Settlements shall be comprehensive, that is, a settlement may not be limited to selected items." We have been informed that future regulations will also specify that only a comprehensive settlement will operate to convert a partner's partnership items to nonpartnership items.

Thus, where a settlement agreement is not comprehensive (i.e., it was not intended to address all of the partnership items at issue) no partnership item will convert to a nonpartnership item and the partner will continue to be governed by the determination of the remaining partnership items at the partnership level. Following the partnership proceeding the tax liability of the affected partners will be determined through a computational adjustment, substituting the previously agreed to items for those items determined at the partnership level.

The partnership period for assessment under section 6229(a) should apply to the partial agreement and computational adjustment. However, since there is a litigation hazard that a court may find that at least the agreed to items convert to nonpartnership items, a waiver of assessment and collection should be included in any such agreement so that tax attributable to these agreed to items may be assessed before the period for assessment under section 6501 or section 6229(f) expire. Where agreements have already been executed without such waiver language, it is our position that we may, nevertheless, immediately assess the agreed to items under the authority of section 6230 although no court has, as of yet, ruled on this issue.

APPLICATION TO INSTANT CASE

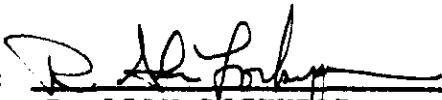
By dictating basis adjustments for future years (paragraph 2), the limit on allowable deductions will be affected. Paragraph 4 provides a beginning number which will affect the future calculation of basis in a TEFRA year. Paragraph 5 dictates the effect of discharge of indebtedness on future income. Paragraph 3 provides for the treatment of investment credit for "any taxable year" which would include future years.^{1/}

^{1/} Some of the events addressed may not occur. For instance, investment credits were only claimed for [REDACTED]. Whether they occur or not is irrelevant, however, since the operation of the conversion provision of section 6231(b)(1)(C) occurs if "the Secretary enters into a settlement agreement with the partner with respect to such items." It is not dependant on whether the addressed events actually occur but rather on the existence of an

The agreement does not otherwise address the treatment (e.g., amount and characterization) of items of income and deduction. Because these items are not addressed, the agreement on its face would leave items to be litigated if the partner's items converted to nonpartnership items. Multiple and inconsistent litigation could occur contrary to the Congressional objective of unified litigation or settlement. Thus the agreement in the instant case will not convert the partner's partnership items to nonpartnership items.

Please refer any questions you may have to Bill Heard at FTS 566-3289.

MARLENE GROSS

By: 
R. ALAN LOCKYEAR
Senior Technician Reviewer
Tax Shelter Branch

agreement "with respect to such items".